

# Initiative 601 Changes the Budget Debate

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For decades, taxpayers have criticized the size, scope and expense of government. Nearly 61 years ago, during the depths of the depression, while FDR and the New Deal were riding high, Gallup pollsters found that 60 percent of those surveyed felt the federal government was spending too much for “relief and recovery.” Another 31 percent thought government spending was “just about right” while only 9 percent thought that government was spending too little.

This snap shot accurately reflects the attitudes of today's voters. Clothing and hair styles have changed a number of times, but the angst over government spending and taxes remains the same.

Today, the average worker spends two hours, 47 minutes each workday laboring to pay off federal, state and local taxes. This is more time, according to The Tax Foundation, than it takes to pay for food, housing and clothing combined.

Here in Washington, frustration over government spending and new taxes reached a fever pitch in the fall of 1993. That November, citizens used the ballot box to put the brakes on government spending.

Despite the doom and gloom predictions of fiscal analysts and editorial writers, citizens still approved Initiative 601 with its sensible spending lid. Since its passage budget writers, led by Republicans, have not only funded critical programs, but they have provided needed tax relief.

## Initiative 601 - The Basics of the Spending Limit

Voters approved Initiative 601 in the November 1993 general election. The initiative establishes a limit on state general fund spending, creates new reserve funds and restricts state revenue increases.

### **Limiting State Spending**

Under I-601, the annual growth in state general fund spending is limited to the average rate of inflation and population increase of the prior three fiscal years. The “fiscal growth factor” is the three-year average rate of population increase and inflation. The factor for the past three years: '94 - 7.11 percent; '95 - 6.21 percent; and '96 - 5.12 percent.

### **Reserve Funds**

All general fund-state revenue in excess of the spending limit is automatically deposited in an Emergency Reserve Fund. I-601 requires a two-thirds vote of both the House and Senate to appropriate money from the Emergency Reserve Fund. If the balance of the fund exceeds 5 percent of biennial general fund revenues, the excess funds are deposited in an Education Construction Fund. A majority vote of the Legislature can appropriate funds from this account for higher education and K-12 construction projects. Money from the Education Construction Fund can be spent for other purposes with the following restrictions: approved by two-thirds vote of the Legislature and Washington's voters.

### **Revenue Restrictions**

Under I-601, any legislative action that raises taxes or makes revenue-neutral tax shifts requires a two-thirds vote of the Legislature. In addition, if the legislative action exceeds the spending limit, voter approval is required.

- Unless prior legislative approval has been granted, I-601 also prohibits agencies from increasing fees at an annual rate that exceeds the same formula used to limit general fund spending,

### Local Government Mandates

I-601 does not allow the Legislature to impose new programs (or increase levels of service under existing programs) on a local government without a specific appropriation to fully cover the costs that will be incurred.

## Putting State Government on a Diet: The Passage of I-601

*In 1996, the average wage-earner worked until May 7 to pay for federal, state and local taxes.*

*(The Tax Foundation)*

What led to the passage of I-601? What events caused voters to seek out a spending lid to curtail the growth in government?

Some might say it was unchecked government spending that pushed taxpayers to act.

- In the last 12 years, Washington state's operating budget has more than doubled, growing from \$8 billion in the 1983-85 budget period to a high of \$17.6 billion for the 1995-97 budget cycle.

Others point to the "results" of the 1993 Democrat-controlled Legislature as the cause of the taxpayer revolt.

- Flush from their 1992 election year sweep, where the Democrats won control of the state Senate and retained their control of the state House of Representatives and the governor's mansion, Democrats approved a big-government agenda. That agenda included new government programs, new government spending, and new taxes and fees. Democrat budget writers made no effort to cut wasteful spending and their tax and fee hikes alone accounted for more than \$1 billion — making it the second-largest tax hike in state history.

When voters approved Initiative 601, they essentially said "no" to taxes and free-spending politicians and "yes" to a more efficient government.

### I-601: A Sobering Impact on the State Budget

Initiative 601 has brought a sobering influence to the budget-writing process. Even Governor Lowry's appointment to head the state Department of Revenue said, "The name of the game has changed dramatically under I-601."

Since the passage of the initiative, state government spending has slowed. Before I-601, growth in state spending usually hit double digits — totaling anywhere from 15 to 25 percent. For example, the 1991-93 budget was nearly 17 percent higher than the 1989-91 budget. One of the larger increases occurred between the 1987-89 and 1989-91 budget cycles when state government spending increased more than 23 percent.

Since passage of Initiative 601, growth in state spending has stabilized at a steady rate of around 8 percent. You only have to look at the first budget written under the rules of Initiative 601 to fully realize the positive impact of the spending limit.

Legislators in 1995, led by Republican budget writers, approved a fiscal plan that spends \$300 million below the initiative's spending limit, but still meets the state's most critical needs. The budget

appropriates \$8 billion for public schools, including pay raises for teachers. Three-hundred million dollars is kept in reserves. And, most importantly to taxpayers, legislators approved \$500 million in tax cuts.

Spending \$300 million below the I-601 lid will save taxpayers millions of dollars down the road. That particular action will reduce the rate of increase under I-601 in future budgets and prevent the spending, according to some estimates, of more than \$1.5 billion over the next six years.

I-601 has worked so well that some one-time critics of the spending lid are now proponents. One Democrat stated at the end of the 1995 session that I-601 “kept the governor from coming in with an \$18.3 billion budget proposal. We were negotiating in a lower range.”

The voter-imposed spending limit moves the state closer to a government that lives within the means of its taxpayers. Many legislators point to the attempts over the past two years to cut taxes instead of raise them as further evidence I-601 is leaving an indelible mark.

It’s important to remember that lawmakers still have to make responsible and reasoned choices when writing state budgets: It falls to legislators to identify spending priorities, to cut government waste and to refrain from cutting essential programs like education.

### Revenue Forecast

A robust state economy is performing better than expected, leading fiscal forecasters to increase revenue projections by \$100 million through 1997.

The state’s chief forecaster, Chang Mook Sohn, says the economy is in good health, citing growth in aerospace and housing markets. He adds that the strong economy will carry over to the next biennium.

The state Economic and Revenue Forecast Council approved a quarterly report recently that projects a total revenue increase of more than \$174 million through 1999.

The state expects to collect \$17.5 billion in taxes and fees for the two-year budget cycle that ends in June 1997.

If that projection holds, the 1995-97 budget will leave the new governor and Legislature with \$515 million in reserve.

### Looking Ahead to the 1997-99 Biennium

The Office of Financial Management (OFM) recently estimated a carry-forward budget for the 1997-99 biennium at \$18.7 billion — the I-601 spending lid is estimated at \$19.04 billion. This means, that for the first-time in many years, there will be no extra pressures from entitlements or carry-forward spending that might create a fiscal crisis.

- A carry-forward budget pulls in the 24-month costs of programs initiated in the previous biennium and removes one-time spending.

OFM estimates carry-forward costs into the 1997-99 biennium will add \$261 million, or about 1.5 percent above 1995-97 spending. What OFM considers mandatory caseload and enrollment increases, such as public school students, medical assistance caseloads and additional prison population, will cost an additional \$392 million. Inflation and other costs will add another \$391 million.

If vendor, grant and salary increases are added, they will boost spending by \$471 million, bringing the 1997-99 biennial total to \$19.128 billion. This figure is only \$89 million over the projected “unofficial” I-601 spending lid.

According to the Washington Research Council:

- K-12 enrollment growth is slowing, which should ease some of the fiscal pressure that has been mounting in recent budget years.
- The absence of a significant budget shortfall will allow the new Legislature to establish priorities without the pressure of a fiscal crisis and makes the prospects for additional tax relief bright.
- But, the state budget continues to be squeezed by medical assistance costs. The Legislature should continue to search for ways to control escalation in state health care spending.

### "A Dollar's Worth of Government"

*Governing Magazine, July 1996*

Does anyone know what it actually costs to fill a single pothole? Newly-elected Indianapolis Mayor Steve Goldsmith unfortunately knew the answer: No one had the foggiest idea. But it wasn't a mystery he was going to live with.

For Goldsmith, cost didn't mean an agency's, a department's, or even a program's bottom line. It means developing a per-unit cost for very specific government services and function, from sealing cracks in roads to issuing building permits.

So the city embarked on what may be the most ambitious big-city effort in the country in what is known as "activity-based costing" (or "ABC"). Only the smallest handful of city and state governments have really made any credible effort at entering what some experts view as the final and most inaccessible frontier in public management and accounting.

According to public service consultants, the biggest challenge to government administrators is how to cost out services uniformly and easily.

Activity-based costing is viewed as the keystone to two of the major trends sweeping state government: performance measurement and competitive contracting.

As more governments gear up to try ABC, they are slamming into a simple but nasty truth: They don't know the actual cost of what they do.

As you can guess, that makes it very hard to determine whether a government program or service delivery system is operating efficiently or whether the private sector could, in fact, do it for less.

Budget directors are quick to point out that in order to cut costs or institute greater efficiencies in a program or a department you first have to develop good information about costs.

Take, for example, sealing cracks in a lane-mile of road. In Indianapolis, that job used to cost \$1,200. After breaking out the costs and analyzing them, the city now pays \$737.

ABC proponents contend that governments should be able to identify not only what it costs to fill a pothole, but also what it costs to issue a driver's license or a building permit, cut an acre of grass, plow a mile of highway, clean up a mile of river bank, put out a car fire, make an arrest, move somebody from welfare to work, chase down a deadbeat dad or process a tax return.

Not everyone likes activity-based costing. A department has to do more than just follow the flow of the tax dollar, which most departments or agencies do pretty well now. Instead, they have to analyze discreet functions of government and then take labor costs (including fringe benefits), rent, equipment,

materials, administrative overhead (including supervisors' salaries) and so forth, and apportion them all to certain activities. It is no surprise that the task is widely viewed as arbitrary, capricious and daunting.

Texas has begun to figure out some per-unit costs — all the money spent on licensing activities and all the money spent on children's programs. According to Texas budget officials, it has helped them identify areas of overlapping spending.

As cities and states look for ways to do more with less, ABC is one system that can help them identify certain efficiencies and inefficiencies.

## Can Spending Cuts Avert a Budget Crisis?

During the early 1990s, both Massachusetts and Washington faced a spending crisis. However the governors from those two states addressed the problems in very different fashions. While one, a Democrat, sought new taxes; the other, a Republican, looked at spending cuts.

When Republican Gov. William Weld was elected in 1990, Massachusetts (otherwise known as Taxachusetts) had taxed and spent itself into a recession and the nation's lowest bond rating.

Weld faced a \$2.6 billion deficit over the next 18 months. While many in the Massachusetts Legislature were calling for new taxes to end the crisis, Weld tried a different approach.

After taking office in 1991, Weld pushed through the repeal of a new 5-percent tax on professional services. The "token" tax cut amounted to \$160 million a year.

To get the budget back in balance, Weld pushed through big cuts in government spending. He reduced government spending by 2 percent below the previous year's level — about 5 percent adjusted for inflation.

He also shut eight of 34 under-used state hospitals. He used privatization to switch work from high-cost public union workers to private firms to clean highways, run skating rinks and perform other tasks. Officials estimate privatization saved taxpayers around \$273 million over two years.

A combination of consolidation, attrition and privatization cut highway department employment by 40 percent, resulting in more savings.

It's estimated Weld cut \$2.6 billion in government spending with the 1991 and 1992 budgets.

One thing is certain the budget cuts didn't hurt the economy. Officials estimate that 110,000 more Massachusetts residents went to work during Weld's early administration. Unemployment also dropped from 9.5 percent (one of the nation's highest) during his first term to 6.9 percent in his third term.

(Massachusetts figures used above are from a December 20, 1993, *Forbes* article "The diet doctor.")

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## NOTES

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